



**CONSUMERS'
FEDERATION
OF AUSTRALIA**

Developing and promoting
the consumer interest

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Senior Adviser
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The Treasury
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Via email: fsi@treasury.gov.au

Dear Sir/Madam

Thank you for the opportunity to provide comments on the Final Report of the Financial System Inquiry, released in November 2014. Implementing a number of recommendations of the Financial System Inquiry has the potential to provide important benefits for consumers, and to improve the operation of the financial system overall.

About the Consumers' Federation of Australia

The Consumers' Federation of Australia (CFA) is the peak body for consumer organisations in Australia. CFA represents a diverse range of consumer organisations, including most major national consumer organisations. Our organisational members and their members represent or provide services to millions of Australian consumers.

CFA's member organisations include membership based organisations, organisations that provide information, advice, counselling or assistance to consumers, and organisations that identify regulations or market features that harm consumer interests and propose solutions. A list of CFA's organisational members is available at <http://consumersfederation.org.au/members/cfa-organisational-members/>.

CFA advocates in the interests of Australian consumers. CFA promotes and supports members' campaigns and events, nominates and supports consumer representatives to industry and government processes, develops policy on important consumer issues and facilitates consumer participation in the development of Australian and international standards for goods and services. CFA is a full member of Consumers International, the international peak body for the world's consumer organisations.

The objectives of the Consumers Federation of Australia are:

- To promote the interests of consumers, in particular low income and disadvantaged consumers, through:
 - Identifying areas in which the interests of consumers are being adversely affected;
- Advocating policy and law reform changes to benefit consumers;
 - Conducting consumer awareness and information programs;
 - Liaising with other consumer and community groups to advance the interest of consumers;
 - Facilitating consumer responses to government, industry and regulators where specific funding or resources are available; and
 - Doing other things to further the interests of consumers.

About this submission

A number of CFA's organisational members have made one or more individual submissions to the Financial System Inquiry, and are likely to also make submissions on the Final Report to Treasury. This CFA submission does not seek to duplicate the individual submissions of members, but to highlight some high level themes that are consistent across the CFA membership, and are relevant to consumers engaging with financial services and financial products.

Fairness – a critical component of the financial system

The CFA is very supportive of the focus on fairness in the FSI's Final Report, and believes that this represents an appropriate development of our understanding about what makes an effective and consumer friendly financial services sector.

In its report, the earlier Wallis Inquiry focused on delivering a financial system that delivered competitive outcomes, while ensuring financial safety and market integrity. From the consumer perspective, the emphasis was on disclosure regulation that would enable consumers and investors to support and drive competition. However, as the experience since the Wallis Inquiry has shown, information disclosure has not been sufficient to moderate unfair and unconscionable practices by some financial services providers. A financial system that operates efficiently and is resilient will not always benefit consumers unless there is also a real commitment to fairness on the part of the policy makers and industry members.

We agree with the FSI Final Report that the underlying principles for the financial services sector should be efficiency, resilience and fairness, and we strongly urge the Government to implement recommendations in the FSI Final Report that are directed towards improving fairness in the system.

Superannuation Objective

We support the FSI's Recommendation 9, to seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system. As was discussed in the context of the Productivity Commission's report on its Consumer

Policy Inquiry, 'clear specification of objectives is fundamental to good regulation'.¹ Superannuation is a major part of the financial services sector, and it is a product with which most Australians will engage. Clarity about the aims and objectives of the superannuation system can assist when developing and implementing policy to ensure a robust and effective superannuation system into the future.

Innovation Collaboration

We support the FSI's recommendation 14 to establish the Innovation Collaboration, to facilitate financial system innovation and enable timely and coordinated policy and regulatory responses. However, such collaboration also needs to have the input of consumer representatives or consumer advocates to ensure that consumer protection issues are addressed at an early stage. Innovation does not always lead to good consumer outcomes, as the example of online payday lending illustrates. Regulatory hurdles to developing and distributing innovative products may reflect and respond to a genuine risk of consumer harm, and it is critical that any Innovation Collaboration or similar mechanism has the benefit of consumer experience and consumer concerns in early discussions about facilitating innovation generally, and in relation to particular products or services.

Mandating the ePayments Code

We support the FSI's recommendation 16 in relation to mandating the ePayments Code. This is a significant regulatory instrument, that has been operating successfully (in its current or previous forms) for a number of years. It has been developed with the input of relevant stakeholders, and represents an appropriate level of consumer protection. Mandating compliance with the ePayments Code would ensure a level playing field for participants in the payments system, as well as certainty for consumers. This obligation could perhaps be linked to the licensing regime, in a similar way to that an obligation to provide dispute resolution services is linked to the licensing regimes in financial services and consumer credit.

Customer surcharging

It was hoped that permitting surcharging would allow the market to develop cost reflective pricing and thus lead to a more efficient payment system. This has clearly failed - in large part due to a failing to properly account for both transaction costs and consumer behaviour. The current regulatory regime for surcharging in consumer transactions is clearly not working. Many merchants, and in some cases, whole industries (for example, airlines, taxis, ticketing services) are continuing to impose surcharges that exceed the reasonable cost of accepting payments. There is currently little enforcement of the RBA's rule, and as a result, there is limited disincentive to overcharge, particularly in markets where there are few players, and competitors are also overcharging.

CFA supports the FSI's recommendation 17 to the extent that more prescriptive limits on surcharging be imposed. However, it remains concerned that, in the absence of enforcement action, there will remain merchants and industries where surcharging remains high. The FSI has suggested that requiring regulators to enforce

¹ Productivity Commission, *Review of Australia's Consumer Policy Framework* (Inquiry Report 107, 30 April 2008), 38.

the reasonable cost surcharging rules would involve considerable administration costs, as well as strengthening regulators' powers to seek information, and creating new penalties to discouraging over-surcharging. This seems to overstate the case – if a regulator were given powers to enforce prohibitions against over-surcharging, the regulator could provide guidance as to how it would exercise those powers (as ASIC currently does in many areas). This could be combined with the setting of more prescriptive limits on surcharging to increase transparency and guidance for consumers and merchants. CFA recommends that a government agency be given responsibility for enforcing the surcharging rules.

CFA is extremely concerned about the excessively long time it is taking to implement an effective surcharging regime and considers that if such a regime is not in place within 2 years there should be a comprehensive review of the arrangements and of other policy options.

Product design and distribution obligation

CFA strongly supports the FSI's recommendation 21, to strengthen product issuer and distributor accountability by introducing a targeted and principles-based product design and distribution obligation. An obligation along these lines will go some way towards increasing fairness in the financial system.

However, we are concerned at the suggestion in the FSI Final Report that such an obligation would not extend to credit products regulated by the *National Consumer Credit Protection Act* (footnote 2, p 198). The FSI suggests that such an obligation is unnecessary for these products due to the introduction of the responsible lending obligation, which requires a consideration of suitability on an individual basis. The proposed product design and distribution obligation is significant precisely because it has broader, market-wide implications. It would require product designers and distributors to consider the characteristics of the target market as a whole, and consider suitability in this sense. These broad obligations complement, rather than compete with, obligations relating to suitability of a product for a particular person.

The NCCPA obligation of responsible lending does not impose any positive obligation on credit providers to consider the characteristics of the target market in the design or distribution of products, nor to stress-test the product to assess how consumers might be affected in different circumstances. Nor does it place any specific obligations on issuers or distributors to periodically review products (from the perspective of the needs of the target market) to inform future product design and distribution. A product design and distribution obligation is also particularly relevant in the consumer credit market, where history has shown a tendency of some players to design and distribute products so as to exploit regulatory loopholes and gaps, rather than to meet consumer needs.

The argument for excluding credit products from this obligation is also weakened by the fact that, in the case of personal advice provided to retail clients under by the Corporations Act, there is also a suitability obligation, in the obligation to act in the best interests of the client. In doing so, the adviser must, among other things, identify the client's relevant circumstances, where relevant make reasonable inquiries to obtain complete and accurate information, conduct a reasonable investigation into relevant financial products, and base all judgments in advising the client on the client's relevant circumstances (s 961B *Corporations Act 2001* (Cth)).

The existence of obligations to consider suitability for individuals in the context of both financial services and consumer credit does not obviate the need to introduce a broader obligation to consider the needs of the target market in the design and distribution process.

In relation to a product design and distribution obligation, however, we suggest that the drafting of it will need to ensure that it is not possible to comply with the obligation by taking into account the target market's characteristics, and then designing or distributing a product in such a way that it exploits those characteristics to the detriment of consumers.

Product intervention power

CFA strongly supports the FSI's recommendation 22, to introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment. This would be an important addition to the regulatory toolkit, and would enable the regulator to act in a preventative fashion, to ensure that potential problems are not realised. Such a power would be an effective complement to ASIC's existing powers that primarily come into play when a contravention has occurred, and where consumers/investors may have already suffered harm. Such a power could be used after a period of consultation, but it should not require the regulator have exhausted all other enforcement options before it is exercised.

CFA also notes that the product intervention power should be available for ASIC's financial services jurisdiction and its credit jurisdiction. As discussed above, there is no logical reason for any additional powers or other regulatory initiatives to have no or limited application in the case of credit products and services.

Disclosure

CFA supports mechanisms to improve disclosure for consumers and investors, and is supportive of the FSI's recommendation 23 and 26. However, CFA reiterates comments expressed in the FSI report, and in many submissions from CFA members and others, that disclosure alone, no matter how well designed, will often not be sufficient to solve consumer/investor problems or to ensure consumers/investors make well informed decisions.

Disclosure is an important part of the regulatory framework, and the designing of disclosure regimes and disclosure documents should take account of the findings of behavioural economics and other explanations of consumer behaviour and consumer decision, and should involve consumer testing as a default practice. This is not to say that more is always better in relation to disclosure. One consequence of relying only or mainly on disclosure has been a tendency to take the "easy" way out and require more disclosure which - as industry often points out - is in fact rarely useful to consumers when what is really needed is some other action such as appropriate restriction on inherently unfair or unsuitable product features.

In order to ensure fairness for consumers/investors, disclosure needs to be supported by a suite of regulatory tools, including the product intervention power, and product design and distribution obligation discussed above. It is also likely that there will be a diminishing return for investment in improved disclosure, such that, in some cases, it would be more effective to focus on other mechanisms for ensuring

fairness, exclusive of disclosure. This is likely to particularly be the case where vulnerable and/or disadvantaged consumers are targeted.

Financial advice

In relation to financial advice, CFA supports the objectives outlined in the Final Report, agreeing that steps must be taken to:

- Improve the culture of financial firms and build consumer trust in those firms;
- Align remuneration structures with a customer-focused culture; and
- Promote efficiency in the financial advice sector through increased consumer participation and engagement (p 217 of the FSI's Final Report).

While we support the FSI's recommendation 24, this recommendation, and others put forward do not fully realise these objectives, only going part of the way to improve consumer outcomes. Notably, more needs to be done to raise standards of conduct, remove all forms of conflicted remuneration (including in the life insurance sector) and increase consumer trust by ensuring that people will always receive fair and timely compensation if something goes wrong.²

CFA strongly supports the FSI's recommendation 40, in relation to renaming 'general advice'. The CFA believes that the term general advice is likely to mislead or confuse many consumers about the scope of the information they are being provided with. A much clearer term needs to be used, one that makes it absolutely clear to consumers and investors that the information that they are being provided with is closer to sales information than to any form of 'advice'. Consumer testing is required to find a term that will be meaningful to the majority of consumers.

Regulator funding and powers

CFA strongly supports the FSI's recommendations 28 and 29, specifically as they refer to the need to provide ASIC with more stable and stronger funding, and stronger powers. The effectiveness or otherwise of the financial services system from the perspective of consumers and investors is very closely tied to the effectiveness of ASIC. To be effective, ASIC needs to have sufficient funding and powers to be a visible regulator, with a proactive surveillance capacity, and a willingness to investigate allegations of non-compliance by businesses of all sizes. CFA is concerned that recent funding cuts are likely to have the opposite effect, and to constrain the capacity of ASIC to monitor the sector overall.

CFA also strongly supports ASIC being provided with a range of regulatory tools, and again commends to the government the FSI's recommendation to provide ASIC with a product intervention power. CFA also believes that a prohibition on unfair trading practices (as found in the European Union), and a mechanism to allow for a regulator to conduct market studies (as found in the United Kingdom) could be important additions to the regulatory framework in the financial services sector and urges the government to explore these options.

² For further detail see CHOICE's submission to Treasury on the Final Report of the FSI.

Compliance costs and policy processes

CFA notes the FSI's recommendation 31, that there be more frequent post-implementation reviews of major regulatory changes. While CFA is not opposed to timely reviews of new arrangements, it is important that such reviews do not just focus on costs to industry. There needs to be a balanced look at the impact, including the benefits that have been provided for consumers and investors. The difficulty here is that the benefits may not always be easily identified or quantified. This is compounded by the lack of investment in Australia in consumer research, including empirical research.

The case studies and data provided by consumer organisations in policy discussions are often criticised as being non-representative and/or anecdotal, and as being an inaccurate reflection of the benefits or costs of a change. However, there is only limited investment by governments in the type of research needed. This is despite a number of recommendations from the Productivity Commission that there is a case for governments to invest in consumer research (including a recommendation in its 2008 Consumer Policy Review)³. In 2009, the former Government released a discussion paper on funding consumer policy advocacy and research,⁴ but there has not yet been any follow up on this paper, or the submissions made to discussion paper. Further, reference to consumer research no longer appears on the strategic agenda for the Consumer Affairs Forum.⁵ CFA strongly urges the Commonwealth Government to work with the State and Territory Governments to develop an appropriate model for funding and coordinating consumer research, in both the financial services sector and other sectors.

Further, the ability of some consumer organisations to engage in policy discussions, including post - implementation reviews, is significantly hampered in the legal advice sector. Prohibitions on using Commonwealth Government funding provided to community legal centres for advocacy risks significantly narrowing the consumer input into policy development in the financial services sector. In its recent report on Access to Justice, the Productivity Commission has recognised the importance of advocacy by legal assistance organisations, as a means of obtaining systemic change, and recommended that Commonwealth, State and Territory Governments provide funding for strategic advocacy and law reform activities.⁶ The advocacy restrictions attached to Commonwealth Government funding for community legal centres are inconsistent with this recommendation, and should be removed.

³ Productivity Commission, *Review of Australia's Consumer Policy Framework* (Inquiry Report 107, 30 April 2008), recommendation 11.3.

⁴ Australian Government, the Treasury, *Consumer Voices: Sustaining Advocacy and Research in Australia's New Consumer Policy Framework: Issues Paper* (2009).

⁵ COAG Legislative and Governance Forum on Consumer Affairs, 'Strategic Agenda: An integrated and harmonised approach to consumer protection' (1 July 2013), 14.

⁶ Productivity Commission 2014, *Access to Justice Arrangements*, Inquiry Report No. 72, Canberra (recommendation 21.1).

Financial inclusion and financial exclusion

One notable absence from the recommendations in the FSI is any measures to address financial exclusion. Although the report references the issue of financial exclusion, it merely notes that the Inquiry "supports continuing industry and government efforts to increase financial inclusion and financial literacy to improve customer outcomes."

More is needed. At the very least, the government should consider the outcome of consultations on the 2012 discussion paper on providing alternatives to payday lending,⁷ and make concrete commitments to measures that will increase financial inclusion in the community. These should include providing more support for alternatives to small, high cost loans, and ensuring that there are alternatives to needing to borrow small loans at all (eg for bills) and that these alternatives are widely promoted. Further, reforms are needed to ensure that credit products offered by fringe lenders (including payday lending and consumer leases) are subject to adequate regulation, and do not exacerbate financial difficulty and financial exclusion for low income and vulnerable consumers. Financial inclusion does not mean access to any financial product; instead financial inclusion exists when consumers are able to access appropriate and affordable financial products.⁸

Another measure that is critical to increasing financial inclusion, and also to improving financial capability is ensuring that there are sufficient financial counselling services across Australia to meet demand. Research demonstrates that financial counselling has a very positive impact, and is a cost-effective use of resources.⁹ Financial counselling services are currently finding it difficult to meet demand; many consumers who would benefit from the services of a financial counsellor are missing out.

It is in this context that CFA notes the current funding uncertain for financial counselling and related services. There is a strong case for the Commonwealth Government to provide appropriate levels of funding for financial counselling, and CFA strongly urges the government to provide funding certainty and funding adequacy for financial counselling services and for Financial Counselling Australia. An alternative is to investigate the potential for industry funding of financial counselling, through a levy on financial services providers, telecommunications companies, utility companies, insurance companies and the debt collection industry. As noted by

⁷ Australian Government, The Treasury, *Strategies for reducing reliance on high-cost, short-term, small amount lending: Discussion Paper* (April 2012).

⁸ Financial exclusion is defined as a lack of access to appropriate and affordable financial services and products: see Connolly C, *Measuring Financial Exclusion in Australia*, Centre for Social Impact (CSI) – University of New South Wales, 2013, for National Australia Bank, p 8.

⁹ For example, Nicola Brackertz, *"I Wish I'd Known Sooner" The Impact of Financial Counselling on Debt Resolution and Personal Wellbeing*, Swinburne University, 2012; Parvin Mahmoudi, Ann-Louise Hordacre & John Spoehr. 2014. *Paying it forward: Cost benefit analysis of The Wyatt Trust funded financial counselling services*. Adelaide: Australian Workplace Innovation and Social Research Centre, The University of Adelaide.

Financial Counselling Australia, a funding model along these lines would provide a secure and stable funding base for financial counselling in Australia.

Further information

For further information about this submission, please contact myself on info@consumersfederation.org.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jo Benvenuti', written in a cursive style.

Jo Benvenuti
Chair
Consumers' Federation of Australia